

**Written Testimony of
Scott C. Cleland
Managing Director of
The Legg Mason Precursor Group**

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On Commerce, Science and Transportation**

**Hearing on
Telecommunications Mergers**

**Scott C. Cleland
Managing Director
Legg Mason Precursor Group
1747 Pennsylvania Ave. NW
Washington, DC 20006
(202) 778-1972**

Mr. Chairman, on behalf of the Legg Mason Precursor Group, thank you for the honor of testifying before your Committee on the topic of mergers in the telecommunications industry.

The views expressed here are mine alone. I request that my full written testimony be printed in its entirety in the hearing record.

By way of introduction, I am not a traditional Wall Street sell-side analyst who analyzes companies or recommends the purchase of stocks. For Legg Mason, I run an investment research group that tracks regulatory, technological, and competitive developments in the communications, technology, and e-commerce sectors for large institutional investors. We focus on trying to anticipate major investment-relevant change coming in the next three to 18 months.

In that context, I offer the following insights and observations in hopes that they will be useful to the Committee.

1) Telecommunications Consolidation Is a Natural Market Development

The current wave of telecom consolidation is a natural and expected market development in a highly capital-intensive business, which demands economic scale.

This natural tendency toward consolidation has been accelerated by:

- pro-competitive regulatory and trade policies that have created a much larger global marketplace; and,
- Internet and digital technology that enable competition between previously separate analog industries.

Economic scale through consolidation makes deployment of broadband infrastructure less expensive, faster and less risky. This can be pro-competitive, pro-deployment and pro-consumer.

• Big Is Not Necessarily Bad

Communications consolidation is not necessarily a bad development for competition and consumers, as long as:

- vigilant antitrust enforcement continues to ensure individual service markets remain competitive; and,
- communications networks continue to be “public” — i.e., open to competition with:
 - facilities-based competition between different broadband “pipes,” and
 - resale competition of each and every local broadband access point to the customer.

If these pro-competitive preconditions are met, telecom consolidation is not a problem for

competition or consumers, because broadband “bundle” competition can flourish. However, any breakdown of competition in the critical component of local broadband access to the customer can have serious anticompetitive implications, because the integrated nature of broadband — i.e., bundling — is like a chain and, like a chain, it is only as strong as its weakest link.

3) **Big Is Not a Problem If Networks Remain “Public,” i.e., Open to Competition**

Despite confusing rhetoric to the contrary, Congress already has decided overwhelmingly that telecom networks should be “public” — i.e., open to competition. In the 1996 Telecom Act, **Congress overwhelmingly voted that market forces alone are not enough to develop or sustain competition in telecommunications**, given the history of monopolization and the presence of economies of scale.

Congress voted overwhelmingly:

- (a) to “force access” (a.k.a. mandate interconnection and resale) on all local exchange carriers (which includes cable when offering telecommunications), so competition could develop; and,
- (b) to require “interconnectivity...to promote nondiscriminatory accessibility by the broadest number of users...to **public** telecommunications networks.”
(emphasis added)

In 1998, the FCC legally required that local broadband access (advanced services) is a form of telecommunications subject to the market-opening provisions of the 1996 Telecom Act.

Meanwhile, the cable industry has been aggressively converting its broadcast **one-way cable network** in which it chooses the content and sends it to all cable customers, into what now appears to be a **two-way telecom network** in which the user chooses the content and sends it to the person(s) of the user’s choice.

In other words, to benefit from the Internet and data growth, cable is reengineering its one-way cable network into a two-way telecom network — at least for voice and data. Despite the transformed physical network, cable maintains that it should not be subject to any of the open-access obligations that every other similarly situated local telecom broadband access provider must comply with.

WorldCom-Sprint, Bell Atlantic-GTE, Quest-USWest, the already-approved SBC-Ameritech, all incumbent local exchange carriers, all competitive local exchange carriers (wireline and wireless), and all long-distance carriers (including AT&T) are “public” networks legally required to be open to both facilities-based and resale competition. All are common carrier public network providers that, by law, have obligations to interconnect and wholesale their service, e.g., “forced access,” in order **to maintain interconnectivity and universal service, and to**

promote competition and innovation.

AT&T and the cable industry are seeking special government protection from standard resale competition that all of their competitors have accepted. The cable industry's position is bold: cable will agree to deploy broadband and compete on a facilities basis in the local phone market only if the government protects cable's core cable, ISP and long-distance businesses from "regulation," i.e., resale competition.

4) Don't Need a Closed Network to Deploy Broadband

Other than cable, open-access is a fact of life and investors implicitly factor "public" open-access obligations into their business models. It is clear that the market does not demand a closed network in order to justify broadband investment.

- The competitive local exchange carriers (CLECs), both wireline and wireless, have raised tens of billions of dollars in capital with "public" open-access obligations.
- WorldCom and Sprint independently have invested heavily in deployment of broadband wireless despite their "public" open-access obligations.
- SBC recently committed \$6 billion to deploy broadband capability to 80% of its customers in three years despite its "public" open-access obligations.
- RCN is not having difficulty raising capital to overbuild both the telcos and the cable plant despite its "public" open-access obligations.

5) Market Forces Don't Necessarily Open Networks

It is naïve to believe that market forces alone will eventually open the cable network to competition. It does not square with past experience or market reality.

- The relative market advantage of being closed when all of your competitors are open is just too powerful to give up "voluntarily." Why is it not in cable's continuing self-interest to be able to sell to its competitors' customers while preventing its competitors from selling to cable's customers?
- When AT&T was a regulated monopoly not subject to market forces, AT&T fought hard to continue as a closed network, but the government broke up the company and opened AT&T's network to competition by mandating "public" open-access obligations, with resulting consumer benefits. Now that AT&T is no longer a regulated monopoly in voice telephony, AT&T still seeks a closed network and is opposing open-access just as

strenuously as it did when it was not subject to market forces.

- If market forces alone open networks, why did Congress require that 15% of cable channels be available for “commercial use” (leased access) in 1984?
- If market forces alone open networks, why did AT&T–TCI deny Internet Ventures, Inc. (IVI) the ability to lease a channel under leased access to offer competitive Internet video programming? And why is IVI having to petition the FCC to gain access? (When will the FCC clarify this fundamental market-opening access issue?)
- If market forces alone open networks, why did Congress in the 1996 Telecom Act mandate interconnection and resale, and make state commissions the arbitrator of interconnection and resale negotiation disputes?

CONCLUSION: BROADBAND ACCESS IS THE BUNDLE PLATFORM OF THE FUTURE — IT NEEDS TO BE OPEN IN ORDER FOR COMPETITION TO FLOURISH

The future of communications is broadband. The success of robust broadband competition depends on required open-access to broadband access platforms (last-mile access facilities) — at least for an initial transition period, so that broadband competition can develop. A fully competitive broadband market depends on the combination of both facilities-based competition between broadband pipes and resale competition on all local broadband access pipes.

Other than requiring open competitive local broadband access to the customer, Internet and data networks should continue to develop free of intrusive regulatory intervention, assuming vigilant antitrust oversight and enforcement.

While many appear to hope that the handful of facilities-based broadband competitors is sufficient to create a competitive broadband market, they ignore the reality that there is very little switching or “competitive churn” in broadband access. One analyst recently quipped that the broadband churn rate is less than moving or death rates.

Unlike long-distance competition that only requires a phone call to switch carriers, switching broadband providers is much more difficult. One has to buy new, expensive equipment and have it professionally installed to reconfigure the system, which can take more than one visit to the home. The competitive reality is that once a provider signs up local broadband customers, they are very “sticky” customers, hence the current rush for “first-mover” advantage. In other words, customers are practically “locked in” to a local broadband access provider, because of the high cost and “hassle” associated with switching.

Once a customer effectively is locked into a local broadband access provider, if there is no

resale of that underlying last-mile access platform, then there is no competitor that can keep that provider's broadband bundle truly competitive. Once cable locks in a local broadband access customer, then the prices can drift higher on the vertically "tied" services in their broadband bundle. Furthermore, no competitor can offer the customer a better deal with its alternative bundle, which resells the underlying cable local broadband access platform.

Without required open-access of local broadband access platforms in the increasingly complex market for broadband bundles, competitive forces won't develop sufficiently or rapidly enough to ensure that consumers are offered maximum choice and protection from anticompetitive pricing of broadband vertical services.

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The attached chart shows how telecom open-access policies have promoted competition in vertical communications markets, preventing anticompetitive leveraging of last-mile access market power. The chart also shows how a closed cable network contributes to less competition in vertical communications markets and allows last-mile access market power to be leveraged all the way into e-commerce.

Attachment: "How Open or Closed Internet Access Affects Competition in E-Commerce"

Source: Legg Mason Precursor Group®